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# Officials From California, S&P Cross Swords Over Rating System

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By Rich Saskal

SAN FRANCISCO -The war of words between the California State Treasurer's Office and Standard & Poor's continued last week at the closing panel of The Bond Buyer's symposium here on the municipal credit crunch.

It was a gentlemanly duel as Standard & Poor's managing director Steven Zimmermann and deputy treasurer Paul Rosenstiel laid out their positions as part of a panel on credit ratings.

The bottom line, according to moderator David Stephens, a managing director at Merrill Lynch& Co.: "Can changing the way we rate bonds really change the market?"

Yes, Rosenstiel believes.

"We do not have a rating system that makes sense," he said. He noted that the treasurer's office is particularly unhappy with Standard & Poor's because that agency has shown no inclination to respond to its concerns about the rating system, which state Treasurer Bill Lockyer believes penalizes municipal bond issuers with unfairly low ratings.

Standard & Poor's does uphold a consistent standard, Zimmermann said.

"Everything we rate investment grade we do not expect to default and we do not expect it to be late," he said. Within that broad category, there is a demand from investors to distinguish among credits, he said.

The rating process is not static, Zimmermann said, and changes as reality changes. "Over time, corporate ratings have been migrating down and municipal ratings have been migrating up," he said.

Moody's Investors Service and Fitch Ratingshave been willing to discuss reforms to the rating system, Rosenstiel said, but Standard & Poor's has not.

"We think S&P continues to stick to what is not an accurate picture of what they say they do, which is to have a single scale," Rosenstiel said.

Not only does Standard & Poor's rating scale not accurately weigh default risks between municipal bonds and corporate bonds, he said, but it also fails to do so among municipal sectors.

Single-A tax-backed bonds have a lesser default risk than airport bonds or hospital bonds rated single-A by Standard & Poor's, according to Rosenstiel. That is because the rating agency demands different capital charges for insurers who wrap those respective bond categories, he said.

"We are committed to one transparent global scale," Zimmermann said. "When we start out, we feel an A is an A is an A," he said.

Rosenstiel said the de facto differences between corporate and municipal credit ratings have cost California money - particularly as the state has pushed harder to sell its bonds to retail.

He said an investor with enough money to buy municipal bonds is an investor who is likely to already have 401(k) and IRA accounts that would hold taxable investments. They should be able to make apples-to-apples comparisons of credit risks, Rosenstiel said. Debt service carries the highest call on California revenue and receives a continuing appropriation, which means debt service payments require no action by the Legislature.

But Standard & Poor's latest credit report for the state - which is rated A-plus - didn't mention that, Rosenstiel said.

"We don't promise to do anything other than pay debt service; you shouldn't rate us based on anything else," he said.

Fitch managing director Amy Doppelt discussed her agency's recent announcement that its chief risk officer, Robert Grossman, is leading an effort to review a possible "harmonization" of the corporate and public finance ratings scales.

"We're approaching it with no preconceptions of what the outcome will be," she said.

"We are very happy that Fitch is undertaking the process that they are," Rosenstiel said.

He used bond insurance as an example of what he described as the bond rating double standard. Moody's, he said, rates bond insurers on its global scale.

When Moody's assigned a global scale rating to California's taxable GOs - it has announced plans to offer them for tax-exempts starting next month - it gave the state's GOs its Aaa global scale rating, in contrast to its A1 municipal scale rating.

"We paid $102 million over the last five years to buy bond insurance, just to get the same rating we already have," Rosenstiel said.